Levine Blaszak Block & Boothby LLP

November 23, 2005

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Ex Parte* Contact in *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45

Dear Ms. Dortch:

This *ex parte* communication is submitted on behalf of the Ad Hoc Telecommunications Users Committee ("Ad Hoc"), (1) to provide recent information on the elasticity of demand for basic telephone service, (2) to discuss changes in the regulatory environment flowing from recent adoption of the broadband wireline Internet access report and order[1] ("*BWIA Order*") that bring into question whether special access and private lines should be subject to separate universal service contribution obligations, and (3) to supplement Ad

[1] *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Universal Service Obligations of Broadband Providers, Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services, Computer III Further Remand Proceedings: Bell Operating Company Provision of Enhanced Services; 1998 Biennial Regulatory Review – Review of Computer III and ONA Safeguards and Requirements, Conditional Petition of the Verizon Telephone Companies for Forbearance Under 47 U.S.C. § 160(c) with Regard to Broadband Services Provided Via Fiber to the Premises; Petition of the Verizon Telephone Companies for Declaratory Ruling or, Alternatively, for Interim Waiver with Regard to Broadband Services Provided Via Fiber to the Premises, Consumer Protection in the Broadband Era*, CC Docket Nos. 02-33, 01-337, 95-20, 98-10, WC Docket Nos. 04-242, 05-271, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853 (2005) ("*BWIA Order*").

Hoc's reasons for opposing assessment of universal service contribution obligations on end user special access and private line service revenues.

Elasticity of Demand

In its May 23, 2005 comments in the Intercarrier Compensation proceeding (CC Docket No. 01-92), Ad Hoc demonstrated*, inter alia,* that there is no evidence that increasing the Subscriber Line Charge ("SLC") would make telephone service unaffordable.[2] Nor is there any evidence that replacing the current revenue-based universal service contribution assessment methodology with a telephone numbers-based methodology would make telephone service unaffordable. The elasticity of demand data used in Ad Hoc's May 23 comments are completely sourced. Footnote 46 of the May 23 comments updates the elasticity data that Ad Hoc previously submitted in this docket. In commenting on the updated elasticity information (contained in a 2002 publication), Ad Hoc stated,

> Other estimates put the value of local service elasticity of demand closer to -0.3 or -0.2.[46] Under those assumptions, the 11% price increase of local service associated with raising the residential SLC by an amount necessary to recover the full $6.9 billion in revenues being generated by interstate and Intrastate switched access charges would result in a corresponding decrease in telephone subscribership levels of 0.34 percent (from 93.5% to 93.2%) in the

[2] Comments of Ad Hoc on the FNPRM, CC Dkt. No. 01-92, (filed May 23, 2005). The cover page and the relevant pages of these Comments are Attachment 1 hereto.

> case of -0.3 demand elasticity, to a decrease of 0.23 percent (from 93.5% to 93.3%) in the case of -0.2 demand elasticity.
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> [46] Lester Taylor, "Customer Demand Analysis," in Martin Cave and other, eds., *Handbook of Telecommunications Economics, vol. 1, Structure, Regulation and Competition* (Amersterdam: Elsevier, 2002) pp. 126-127. See, in the same volume, Michael H. Riordan, "Universal Residential Telephone Service," at 447.

Additional demand elasticity data and comments thereon are found in a Progress and Freedom Foundation ("PFF") October 2005 document entitled "Digital Age Communications Act, Preliminary Proposal of the Universal Service Working Group, Release 1.0." The PFF quotes from the work of Jerry Ellig, a Senior Fellow at George Mason University's Mercatus Center:

> [M]ost research suggests that cross-subsidies from long-distance to local service generate little increase in telephone subscriptions. Consumer decisions to subscribe to telephone service are not very sensitive to the fixed monthly charge.[12] In other words, local service has a relatively low price elasticity of demand. This elasticity appears to have fallen over time. Several recent studies using census data, for example, have found that the elasticity in 1999 was about one-third of the value in 1970, and in 2000 it was only one-eighth of the 1970 value.[13] It may even equal zero in the United States and other developed countries.[14]
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> [12] Jerry Ellig, *Public Interest Comments of the Mercatus Center Regulatory Studies Program on Unified Intercarrier Compensation* at 6 (May 2005), *citing* A.H. Barnett & David L. Kaserman, *The Simple Welfare Economics of Network Externalities and the Uneasy Case for Subscribership Studies,* 13 J. Reg. Econ. 252-53 (1998); Michael H. Riordan, *Universal Residential telephone Service,* in HANDBOOK OF TELECOMMUNICATIONS ECONOMICS 431 (Cave, Majumdar & Vogelsang eds. 2002); David L. Kaserman, John W. Mayo & Joseph E. Flynn, *Cross-Subsidization in Telecommunications: Beyond the Universal Service Fairy Tale,* 2 J. Reg. Econ. 231-49 (1990)

[13] Ellig, *citing* Christopher Garbacz & Herbert G. Thompson, *Estimating Demand with State Decennial Census Data from 1970-1990,* 21 J. Reg. Econ 326 (2002); Garbacz & Thompson, *Estimating demand with State Decennial Census Data from 1970-1990: Update with 2000 Data,* 24 J. Reg. Econ. 376 (2003)

[14] Ellig *citing* Garbacz & Thompson, *Universal Telecommunications Services: A World Perspective,* 17 Information Economics and Policy 495-512 (2005); Robert W. Crandall & Leonard Waverman, WHO PAYS FOR UNIVERSAL SERVICE? WHEN TELEPHONE SUBSIDIES BECOME TRANSPARENT 91 (Brookings Institution Press 2000).

In its February 16, 2005 *ex parte* submission in this docket (Attachment 2 to this letter) responding to *ex parte* communications made by the West Virginia Consumer Advocate and the Keep USF Fair Coalition, Ad Hoc cited a study by Jerry Hausman and Howard Shelanski, *Economic Welfare and Telecommunications Regulation: The E-Rate Policy for Telecommunications Subsidies,* 16 Yale J. on Reg. 19, *38 n.85 (1999), which had estimated the price elasticity of demand for local telephone service at approximately –0.005. While Ad Hoc's May 23, 2005 *Intercarrier Compensation* comments in CC Docket No. 01-92 addressed the potential effect of an 11% price increase in basic telephone rates "associated with raising the residential SLC by an amount necessary to recover the full $6.9 billion in revenues being generated by interstate and Intrastate switched access charges,"[3] the effect of shifting Universal Service Fund ("USF") collections from a revenue-based charge to a numbers-based charge would be enormously smaller. Federal Communications Commission (the "Commission") data show the average total monthly rate for basic residential flat-

[3] Attachment 1 at 21.

rate local telephone service in urban areas at $24.31 as of October 15, 2004.[4] In its February 16, 2005 *ex parte* submission in this docket, Ad Hoc noted that "[g]iven that the average residential interstate subscriber line charge ("SLC") is $6.00 per month, the revenue-based surcharge on the SLC alone would be $0.90 per month, assuming a surcharge capped at 15%." At a numbers-based USF charge in the range of $1.00, this translates into a *worst case* monthly increase (for a customer with zero interstate usage) in the range of about ten cents, or about *four-tenths of one percent* of the $24.31 monthly local service rate. In its May 23, 2005 *Intercarrier Compensation* comments and using price elasticity estimates of between –0.2 and –0.3 and assuming the 11% rate increase, Ad Hoc had estimated a drop in residential service penetration of between 0.23% and 0.34%. In the instant case, with a rate impact of the order of 0.4% and applying the *Hausman/Shelanski* price elasticity estimate of –0.005, the potential drop of in residential connectivity is *immeasurably small*.

There is no evidence in this proceeding challenging this elasticity data and the resulting conclusions.

USF Assessments on Broadband Wireline Non-Internet Access Facilities

[4] Industry Analysis and Technology Division, Federal Communications Commission, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, rel. May 2005 ("Reference Book"), at Table 1.1.

Ad Hoc has reconsidered the advisability of assessing USF contributions on dedicated high speed connections, including special access connections. Previously Ad Hoc has supported the application of USF surcharges on special access services purchased by end users using a base unit charge, *i.e.,* the per assigned number charge multiplied by economically reasonable equivalency ratios. Specifically, Ad Hoc has supported the use of the equivalency ratio's originally proposed as part of the CoSUS plan.[5] However, in light of the Commission's recent Order in the Broadband Wireline Internet Access proceeding; Ad Hoc has concluded that a USF assessment mechanism that excludes broadband connections used for Internet access, but includes assessments on other broadband connections could in the long run inject instability in the USF funding mechanism and competitive unfairness into the enterprise customer Internet access market. The risks of instability and competitive unfairness outweigh the extremely modest benefits derived from assessing USF contributions on special access circuits.

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[5] Ad Hoc Telecommunications Users Committee, Comments, *Federal-State Joint Board on Universal Service, 1998 Biennial Regulatory Review, Streamlined, Contributor Reporting Requirements Associated With Administration of Telecommunications Relay Service, North American Numbering Plan, Local Number Portability, and Universal Service Support Mechanisms, Telecommunications Services for Individuals with Hearing and Speech Disabilities, and the Americans with Disabilities Act of 1990, Administration of the North American Numbering Plan and North American Numbering Plan Cost, Recovery Contribution Factor and Fund Size, Number Resource Optimization, Telephone Number Portability, Truth-in-Billing and Billing Format*; (CC Docket

In the *BWIA Order* the Commission essentially found that wireline broadband services, when used by facility-based providers of broadband wireline Internet access for the purpose of providing Internet access, are not "telecommunications services" and as such, eventually will not be subject to the USF collection mechanism.[6] While the most common LEC residential Internet access service available today is DSL, the *BWIA Order* does not limit its findings to DSL. Verizon's FiOS service, for example, offers a fiber-based broadband Internet access capability at speeds up to 30 MBPS that would fall under the new BWIA rules. Attachment 3 to this letter contains pages from Verizon's website that claim FiOS is "poised to handle the cutting edge broadband applications of the future."[7] Verizon offers FiOS at a monthly rate of $35.95 to $39.99 for a 2 MBPS up / 5 MBPS down service, $44.95 to $49.99 for a 2 MBPS up / 15 MBPS down service and $179.99 to $199.99 for a 5 MPBS up / 30 MBPS down service.[8] FiOS has greater capacity than many special access connections, and certainly will be used for many applications, including voice, which is a telecom service, and Internet access and entertainment services which are not.

No. 96-45, CC Docket No. 98-171, CC Docket No. 90-571, CC Docket No. 92-237, CC Docket No. 99-200, CC Docket No. 95-116), filed April 18, 2003.

[6] *BWIA Order* at paras. 112 and 113.

[7] Verizon Website, "About FiOS" http://www22.verizon.com/FiOSforhome/channels/FiOS/root/about_FiOS.asp, (accessed November 17, 2005).

[8] Verizon Website, "FiOS Prices and Packages" http://www22.verizon.com/FiOSforhome/channels/FiOS/root/package.aspx, (accessed November 17, 2005).

As enterprise customers' telecommunications networks become IP networks, applications will converge on single integrated networks with bundled pricing. Internet access will be one of many applications using these converged networks. Network capacity rather than usage will be sold. Networks will not distinguish between voice packets, video packets, data packets and Internet usage packets, except when quality of service markers are attached to real time applications, such as voice.[9] But not all users will utilize QoS markers. Moreover, in any period of time Internet access service will consume more or less of the bandwidth on IP networks, and it will be impossible to determine reasonably how much capacity is consumed by Internet access. Such determinations, however, would be necessary because Internet access service is not subject to USF contributions as a result of the regulatory classification of that service under the *BWIA Order*. All of the same problems will beset FiOS and similar exchange carrier offerings. The implications of the *BWIA Order* and rapidly emerging network technology make clear that imposing USF contributions on special access circuits would be anything but visionary.

[9] Nor would the Commission want carriers to attempt to identify the applications embedded in packets (assuming that such identification would be feasible) because (1) peering into the content of customer usage would jeopardize personal privacy and business security interests and (2) would likely impose added costs on service providers that they then would pass onto residential and business subscribers, resulting in the Commission being responsible for more dead weight loss imposed on the economy.

Moreover, in converged networks that support voice, data, video and Internet access services, special access services and services such as FiOS will support voice applications that require telephone numbers. Thus, customers of high capacity services will continue to support the USF because they will use services that need telephone numbers. The level of support would vary among service configurations because in some instances, the high-capacity connection will support a large number of telephone numbers, whereas in other instances, such connections will support few telephone numbers.

Ex parte materials filed by members of the Intercarrier Compensation Forum on July 29 of this year demonstrate that a decision to remove special access services from the new USF assessment mechanism would result in an increase of only $0.03 per month in the required level of a "per number" charge.[10] The additional complexity, instability and possible dead weight that would be embedded in the plan through the inclusion of an assessment upon special access services is simply not justified by a $0.03 per month differential in the overall unit charge.

The beauty of a numbers-based assessment mechanism is its simplicity. There are a finite and countable quantity of telephone numbers. A fairer and more rational system than numbers simply does not exist. A working telephone

[10] *Ex Parte* submission of members of the Intercarrier Compensation Forum in CC Docket No. 96-45 (filed July, 29, 2005).

number is a working telephone number, and anybody who wants to originate and receive calls over the public switched network must have one.

Based upon the foregoing, Ad Hoc submits that a replacement USF mechanism should be based entirely upon numbers, with no assessments on dedicated connections of any kind.

USF Assessments on Special Access Revenues

Although Ad Hoc has, up to this filing, supported the application of USF surcharges on special access services purchased by end users using a base unit charge and reasonable equivalency ratios. Ad Hoc has, however, consistently opposed imposition of USF contribution obligations on special access services if such obligations are based on uneconomic equivalency ratios or revenues; and it continues to do so.

For example, on August 15, 2005, Ad Hoc urged the Commission to reject Verizon's call to assess special access services based on revenues:

> Ad Hoc's last material concern with Verizon's *ex parte* goes to Verizon's suggestion that special access services bear USF assessments based on interstate revenues in the same proportion as they are assessed today. Ad Hoc has explained and demonstrated over and over again that local exchange carriers are charging excessive special access service rates when given pricing flexibility and, of course, realizing excess revenue. Imposing a USF burden based on current USF revenues would unreasonably burden special access subscribers (including end user purchasers of retail level services

> that use special access as an input). Moreover, Verizon's suggestion would result in numbers-based assessments being computed on a residual basis. This approach actually makes numbers-based assessments less stable than would be the case if sensible capacity ratios are used to compute for special access contributions. If the capacity ratios are set at non-distorting levels (as Ad Hoc has recommended throughout this proceeding), special access and high capacity USF assessments, contrary to Verizon's assertions, will not discourage the development of faster connections and will not repress demand for such connections. The Commission, of course, is aware that the exceptions to application of a uniform numbers-based USF charge or to application of a charge on special access and high capacity lines based on multiplying the basic per number charge by technologically and economically rational equivalency ratios will impact the working number assessment. A properly formulated number-based USF assessment methodology would not materially repress demand for switched or special access services, would be competitively neutral and a vast improvement over the current USF assessment methodology.[11]

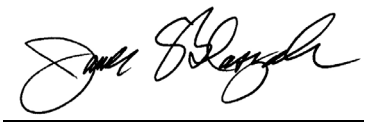
Again, at an October 25, 2005 meeting with the Chief, Wireline Competition Bureau and his staff, Ad Hoc opposed assessing USF contribution obligation on special access and private line services based on revenues for those services. Using a revenue-based assessment methodology for special access and private line services and a telephone numbers-based assessment methodology for other services would subject one category to a residual contribution obligation. A USF contribution methodology with a residual

[11] *Ex Parte* submission of Ad Hoc in CC Dkt. No. 96-45 (filed August 15, 2005) at

component holds significant potential for manipulation and economic inefficiency.

No legitimate public interest objective would be served by adoption of a USF contribution methodology that uses a residual component.

Sincerely,



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2-3. This submission is Attachment 4 hereto.